

Clarifications to HKFRS 15



Introduction

The Clarifications to HKFRS 15 “Revenue from Contracts with Customers”, following the IASB’s equivalent clarifications to IFRS 15, clarify the IASB’s intentions when developing the requirements in IFRS 15 but not to change the underlying principles of IFRS 15. The Clarifications provide additional guidance on three areas of HKFRS 15: (i) identifying performance obligations; (ii) principal versus agent considerations; and (iii) licensing. The Clarifications also include further transition relief for completed contracts and modified contracts.

Effective Date

An entity shall apply the Clarifications retrospectively for annual periods beginning on or after 1 January 2018. Earlier application is permitted. An entity shall apply the Clarifications as if they had been included in HKFRS 15 at the date of initial application.

Summary of Clarifications

Identifying performance obligations

One of the criteria to determine whether a good or service is distinct is that the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

The Clarifications clarify that in assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable, the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

- (a) the entity provides a significant service of integrating the goods or services, as inputs, with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs.
- (b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.
- (c) the goods or services are highly interdependent or highly interrelated.



Summary of Clarifications

Principal versus agent considerations



When another party is involved in providing goods or services to a customer, an entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e. a principal) or to arrange for those goods or services to be provided by the other party (i.e. an agent).

The Clarifications clarify that an entity determines whether it is a principal or an agent for each specified good or service promised to the customer. To determine the nature of its promise, the entity shall identify the specified goods or services to be provided to the customer; and assess whether

it controls each specified good or service before that good or service is transferred to the customer.

An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer.

The Clarifications clarify that when another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of any one of the following:

- (a) a good or another asset from the other party that it then transfers to the customer.
- (b) a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.
- (c) a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer.



The indicators to determine whether an entity is a principal or agent is reframed by the Clarifications to indicate when an entity is a principal rather than when it is an agent. Indicators that an entity is a principal include, but are not limited to, the following:

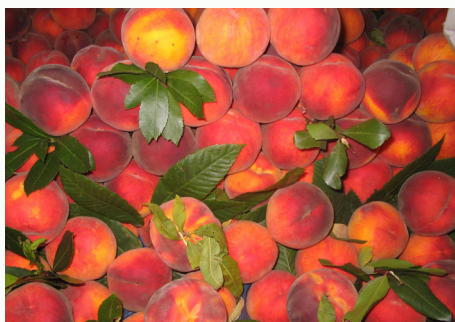
- ▶ the entity is primarily responsible for fulfilling the promise to provide the specified good or service.
- ▶ the entity has inventory risk.
- ▶ the entity has discretion in establishing the price for the specified good or service.

The indicators in relation to the form of consideration and exposure to credit risk are removed as these indicators are not helpful in determining whether an entity is a principal.

The indicators above may be more or less relevant to the assessment of control depending on the nature of the specified good or service and the terms and conditions of the contract. In addition, different indicators may provide more persuasive evidence in different contracts.

Summary of Clarifications

Licensing



Determining the nature of the entity's promise

One of the criteria to determine whether the nature of an entity's promise in granting a licence is a promise to provide a right to access the entity's intellectual property is that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights.

The Clarifications clarify that an entity's activities significantly affect the intellectual property to which the customer has rights when either:

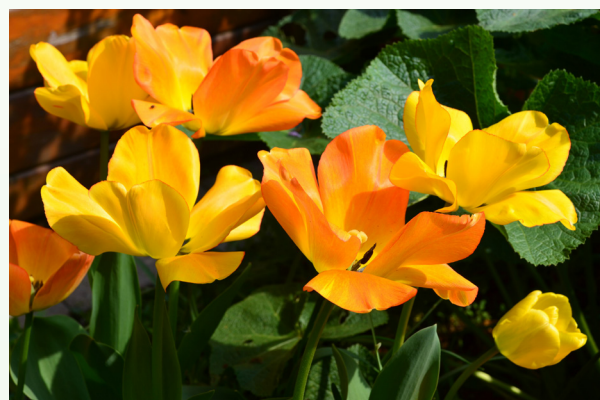
- ▶ those activities are expected to significantly change the form or the functionality of the intellectual property; or
- ▶ the ability of the customer to obtain benefit from the intellectual property is substantially derived from, or dependent upon, those activities.

Sales-based or usage-based royalties

An entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when the later of the following events occurs:

- ▶ the subsequent sale or usage occurs; and
- ▶ the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied.

The Clarifications clarify that the above requirement for a sales-based or usage-based royalty applies when the royalty relates only to a licence of intellectual property or when a licence of intellectual property is the predominant item to which the royalty relates. Otherwise, the requirements on variable consideration apply to the sales-based or usage-based royalty.



Summary of Clarifications

Transition relief

An entity shall apply HKFRS 15 using one of the following two methods:

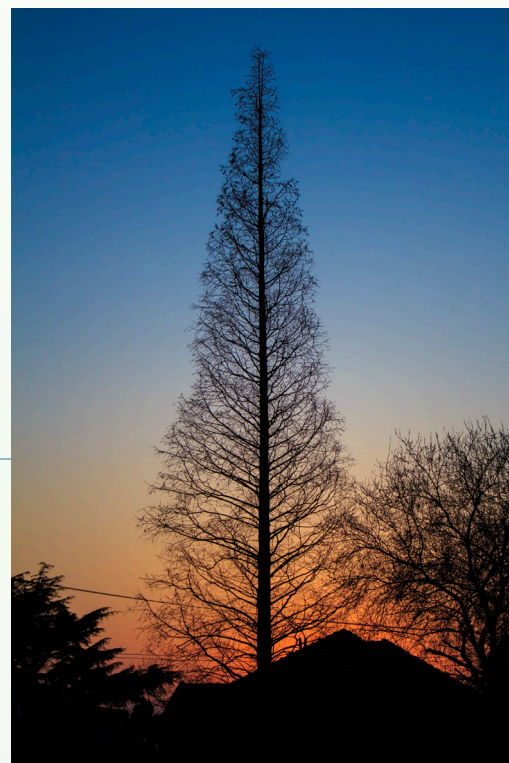
- ▶ retrospectively to each prior reporting period presented and may use one or more of the practical expedients ("Retrospective Approach"); or
- ▶ retrospectively with the cumulative effect of initially applying HKFRS 15 recognised at the date of initial application ("Modified Retrospective Approach").

The Clarifications add two practical expedients to the Retrospective Approach:

- ▶ An entity need not restate contracts that are completed contracts at the beginning of the earliest period presented.
- ▶ For contracts that were modified before the beginning of the earliest period presented, an entity need not retrospectively restate the contract for those contract modifications. Instead, an entity shall reflect the aggregate effect of all of the modifications that occur before the beginning of the earliest period presented when: (i) identifying performance obligations; (ii) determining transaction price; and (iii) allocating transaction price.

The Clarifications also add the following transition relief to the Modified Retrospective Approach:

- ▶ An entity may elect to apply HKFRS 15 retrospectively only to contracts that are not completed contracts at the date of initial application.
- ▶ An entity may also use the above practical expedient of the Retrospective Approach in relation to modified contracts, either for all contract modifications that occur before the beginning of the earliest period presented; or occur before the date of initial application.



Finally, the Clarifications amend certain illustrative examples and add new illustrative examples.

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